Appendix I. Letter of Intent

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Kyiv, November 8, 2021

Ms. Kristalina Georgieva
Managing Director
International Monetary Fund
Washington, DC 20431

Dear Ms. Georgieva:

1. We reaffirm our commitment to the policies and objectives of the economic program supported by an IMF arrangement under the Stand-by Arrangement (SBA). In the attached supplement to the Memorandum of Economic and Financial Policies (MEFP) from June 2, 2020, we outline further policy steps toward meeting these objectives.

2. We have provided appropriate policy support to contain the health and economic impact of the COVID-19 pandemic on Ukraine. The balance of payments and budgetary support under the first tranche of the SBA provided an important boost to reserves and allowed us to put in place a fiscal package aimed at reorienting expenditure toward healthcare and social support and scaling up public investment in roads to create jobs and offset weak private sector activity. Our 2021 budget continues to provide support to the recovery. Our fiscal policy efforts were complemented by substantial monetary easing in 2020 and targeted measures to provide temporary liquidity support to banks. Taken together, these measures have cushioned the economic effect of the pandemic and output contracted by less than expected at the time of the program request. On the health front, our vaccination campaign started in February, and as of mid-October we have fully vaccinated about 6.3 million people against a target of 17 million by end-year.

3. We met all continuous and end-December 2020 quantitative performance criteria (QPCs) and indicative targets (ITs), except for the QPC on government guarantees; inflation has also accelerated above the Monetary Policy Consultation Clause (MPCC) outer band (Table 1) in 2021. We have implemented seven out of the nine structural benchmarks set for the period from end-June 2020 through end-March 2021, including through prior actions for the first review (Table 2). We have taken corrective actions in response to implementation slippages and unanticipated shocks. Specifically, we are requesting a waiver for the non-observance of a performance criterion for end-December 2020 based on corrective actions already taken. We have also attached a separate letter outlining the underlying reasons for the inflation deviation, as well as our policy response, as part of the monetary policy consultation with the IMF's Executive Board. To address the consequences of decisions taken by the Constitutional Court of Ukraine on key elements of our anti-corruption framework, we have enacted amendments to the relevant legislation to ensure that the framework remains operational and effective in investigating and prosecuting high-level public sector corruption.

4. We request that the structural benchmark on the audit of COVID-related spending be reset as outlined in the attached MEFP and propose several new benchmarks to help maintain the reform momentum and strengthen risk management (see Table 2). Specifically,

- To support the implementation of the recently enacted law on the High Council of Justice (HCJ), we propose an end-April 2022 structural benchmark on the completion of the one-time integrity check of existing HCJ members.

- On asset recovery, we propose to elevate to a structural benchmark the delayed MEFP commitment to adopt a comprehensive asset recovery strategy and have already taken first steps to deliver on that commitment.

- We recognize that adhering to good corporate governance remains an important safeguard in the state-owned financial sector and the state-owned energy sector, and we propose three new structural benchmarks in this area, aiming to ensure proper renewal of supervisory boards in state-owned banks and to install corporate governance in a key energy company to strengthen financial sustainability in the sector. Looking forward, to be able to advance our strategy for decreasing the state's ownership share in the banking sector, we propose developing a concrete roadmap ahead of the next review that could form the basis for further commitments.

- We will step up our efforts to prevent the buildup of quasi-fiscal deficits in the energy sector. To that end, we are committing to eliminate the stock of arrears to producers of renewable energy and prevent future debt accumulation (monitored through a new performance criterion). We will implement further measures (with new structural conditionality) to enhance competition in the retail and wholesale gas markets. In response to the recent sharp increase in gas prices will ensure adequate support to vulnerable groups by ensuring sufficient appropriation for the Household Utility Subsidies (HUS) program and provide transparent budget support, as needed, to ensure security of gas supply during the 2021–22 heating season.

5. We remain committed to maintaining the institutional strength of the National Bank of Ukraine (NBU), in recognition of the key role it has played in macroeconomic management and financial stability. The complex global environment underscores the importance of maintaining sound monetary, financial, and exchange rate policies. We have enacted a set of amendments designed to further strengthen the autonomy and governance of the NBU and will put in place a plan to address staff turnover and retain capacity in bank supervision. To ensure the continuity and integrity of monetary and financial policies, we will continue to uphold good governance practices in the context of the collegial and inclusive decision-making culture that we developed under the post-2014/2015 reforms of the NBU.

6. On the basis of steps that we have already taken and our commitments for the period ahead, we request completion of the first review, and a disbursement in the amount of SDR 500 million based on the end-December 2020 performance criteria. Given the delay in completing this review, we request an extension of the program to June 30, 2022 and a rephasing of remaining purchases. This would entail a second review under the arrangement, on or after March 4, 2022, based on the end-December 2021 performance criteria and a third review, on or after June 3, 2022, based on end-March 2022 performance criteria, as set out in Table 3. Furthermore, we also request the completion of the financing assurances review, and approval of the retention, for a period of 12 months, of the exchange restriction and multiple currency practices that are inconsistent with our obligations under Article VIII Sections 2 (a) and 3 of the Fund's

Articles of Agreement. The exchange restriction is non-discriminatory and maintained temporarily due to balance of payments difficulties, while the multiple currency practices do not materially impede balance of payments adjustment or harm the interests of other Fund members, and are also non-discriminatory. During the period of the SBA, Ukraine will not introduce or intensify exchange restrictions, introduce or modify multiple currency practices, and will not introduce or intensify import restrictions for balance of payments reasons nor conclude bilateral payment agreements that are inconsistent with article VIII of the Fund's Articles of Agreement.

7. We remain confident that the policies set forth in the attached MEFP are adequate to achieve the macroeconomic and financial objectives of the program and stand ready to take any additional measures that may become appropriate for this purpose. We will consult in advance with the IMF on the adoption of these measures and on any revisions to the policies contained in the MEFP, in accordance with the IMF's policies on such consultation. We will refrain from any policy that would be inconsistent with the program's objectives and our commitments laid out in the MEFP. We will provide IMF staff with the data and information it requests for the purpose of program monitoring. Reaffirming our commitment to transparency, we consent to the IMF's publication of this letter, the MEFP, the Technical Memorandum of Understanding (TMU), and the accompanying Executive Board documents immediately upon consideration of our requests by the IMF's Executive Board.

Yours sincerely,

Volodymyr Zelenskyy President of Ukraine	**Denys Shmyhal** Prime Minister of Ukraine
Sergii Marchenko Minister of Finance of Ukraine	**Kyrylo Shevchenko** Governor, National Bank of Ukraine

Attachment I. Memorandum of Economic and Financial Policies

November 8, 2021

1. **Our policies will continue to focus on addressing the economic and health crisis caused by COVID-19, while maintaining macroeconomic and financial stability, reducing vulnerabilities, and tackling key obstacles to private investment.** As the crisis resulting from the COVID-19 outbreak intensified and the macro-economic outlook worsened, we adopted and implemented an emergency 2020 fiscal package aimed at reorienting expenditure toward healthcare and social support, and frontloaded public investment in roads to create jobs and offset weak private sector activity. Our 2021 budget aimed to continue to provide support to the recovery, largely through policies that boost private consumption. Fiscal policy efforts were complemented by substantial monetary easing in 2020 and a set of targeted measures to provide temporary liquidity support to banks. Taken together, these measures have cushioned the effect of the pandemic. As the recovery takes hold, we are committed to (i) returning fiscal policies to settings consistent with medium-term debt sustainability while protecting the socially vulnerable, strengthening revenue administration, and reducing fiscal risks from quasi-fiscal operations; (ii) safeguarding central bank independence and focusing monetary policy on returning inflation to its target; (iii) ensuring banks' financial health, including through good governance, with the goal of reviving sound bank lending to the private sector; (iv) tackling corruption and pushing forward with the implementation of judicial reform; and (v) and reducing the role of the state and vested interests in the economy to— improve the business environment, attract investment and raise the economy's potential. In recognition that vaccination efforts are key to sustaining economic recovery, we have secured sufficient vaccine supply and aim to vaccinate at least 17 million people by end-2021.

2. **We have made progress in auditing the 2020 budget program for COVID-related spending and we will complete[1] and publish the audit by end-2021.** The budget program "Fund to Fight Against COVID-19 and its Impact", established through the 2020 supplementary budget, has been discontinued, and a partial ex-post audit by the State Audit Service has been completed, covering UAH 44.5 billion out of UAH 66.5 billion spent. We have published our audit findings covering expenditures by the Ministry of Health, Ministry of Social Policy, and Ministry of Culture and Information Policy through the webpage of the State Audit Service. We will not audit 100 percent of the funds as we do not plan to audit all of the funds used for social security—given that so far violations in this area were very small and the costs of a comprehensive audit in this area by far would outweigh the benefit. We will complete the audit of the remaining portion of the funds spent out of this budget program—mostly spent by the state road fund (UAH 13.3 billion)—by end-December 2021 ***(structural benchmark,*** reset from end-March 2021). While confidentiality agreements with suppliers may not allow for public disclosure of details on some spending, we are

[1] The effective completion rate of the audit would stand at 85 percent. We will stop the audit of social insurance spending at about 72 percent, as we have found very low levels of violations (UAH 9 million) in this area, and established controls over implementation and eliminating violations. Registration for salary supplements was made through the digital platform Diya, significantly limiting the scope for misdirection of such expenditure.

currently exploring options to make this possible. We have referred 212 cases to law enforcement agencies and are committed to fully cooperate with any potential criminal investigations in relation to COVID-related spending, including by providing access to evidence collected as part of the audit process. In addition, we have published all procurement notices in a manner readily accessible to the general public and have made all purchase orders, including information on beneficial owners of the participating bidding companies, electronically accessible to the public on the ProZorro internet site *(https://prozorro.gov.ua/).*

A. Fiscal Policies

3. We are on track to meet our 2021 budget deficit target, despite recent expenditure pressures. The deficit of the general government will not exceed UAH 237 billion as per the IMF definition, which corresponds to a deficit of the state budget of UAH 246.6 billion. Tax revenue has overperformed, mostly on the back of stronger than expected commodity prices and a rebound in imports, allowing us to increase expenditures through two supplementary budgets and allocate it for road construction and maintenance. We are currently formulating a third deficit-neutral supplementary budget for 2021 of about 0.8 percent of GDP, which will increase by roughly equal amounts: (i) wage bill for military and healthcare workers; (ii) maintenance of roads; (iii) capital expenditure on roads; and (iv) Household Utility Subsidy program (HUS). While the deficit has remained in check, given large gross external financing needs including a significant amount of debt maturing that was issued at concessional rates, we have used about half of the recent general SDR allocation; we intend to retain the remainder of the allocation as a buffer against future risks, which also helps to buttress our external stability objectives.

4. In response to the recent extraordinary increases in gas prices, we will implement transparent measures to protect the vulnerable population, strengthen the financial position of municipality-owned District Heating Companies (DHCs), and provide temporary and exceptional liquidity support to state-owned Naftogaz. We expect to execute the following set of actions without widening the 2021 deficit in light of the projected additional revenue overperformance, including from gas royalties which are linked to gas import prices.

a. We will introduce amendments to the 2021 budget increasing allocation to the HUS by UAH 12 billion. This should be sufficient to ensure adequate coverage through end- December 2021, in light of the fact that pressure on gas prices facing households is also contained by the fixed-price contracts concluded by Naftogaz in April/May of this year.

b. We will provide a subsidy for the 2021-22 heating season for the poorest municipalities[2] of up to UAH 1 billion and provide further support to municipalities in the 2022 budget by redistributing to local budgets a part of PIT in the amount of UAH 11.4 billion (4 percent of PIT revenues). The remaining DHC liquidity need will be covered by municipalities from their own budgets.

c. The MGU/GTSO has pre-paid to Ukrtransgas UAH 27 billion as part of a new agreement

[2] Refers to municipalities below the 90 percent threshold of the tax capacity index.

replacing the original sale purchase agreement (SPA) by fixed annual payments over the period 2020-24. We will suspend further execution of the emergency order until a proper assessment of its implications can be completed by the newly appointed supervisory board of MGU (see ¶31). Instead, any remaining liquidity gap at Naftogaz during the upcoming heating season would be covered by a transparent and direct budget transfer, in recognition of the company's role in energy security and the subsidy element implicit in current gas supply contracts. Such support is expected to be budget neutral in light of the royalty revenue overperformance. Naftogaz's liquidity situation is expected to improve in 2022 as prices move closer to market terms once the current fixed price sale contracts expire in April, aided by structural measures described in ¶30 and ¶32 below.

5. We will approve a 2022 budget that targets a general government deficit[3] of 3.5 percent of GDP *(structural benchmark,* end-November 2021), continuing on a path of gradual fiscal consolidation, and prioritizing a boost to healthcare, education and defense and security spending. In line with the recently approved Presidential decree #261/2021 dd. 18.06.2021, funding for the guaranteed healthcare package has been increased substantially to allow for an increase in wages of doctors and secondary medical staff of about 30 percent on average. These changes will be reflected in a CMU resolution which will increase the tariffs and capitation rate accordingly. The education sector will receive sufficient funding to finally meet the 7.3 percent of GDP target stipulated in the law on education. Specifically, wages of teachers will be increased by about 8 percent to keep them in line with the increase in social standards, stipends for students will be increased by about 50 percent. We will ensure that the defense and security budget will be above the floor of 5 percent of GDP, with additional funding partly allocated to the support of veterans. To make space for these important priorities, we will limit the increase in the minimum wage and the wage bill of other public sector workers to inflation plus two percent, and we will further strengthen the targeting of social programs.

6. To provide additional fiscal space to increase priority expenditures in 2022, we have prepared a tax package of about 0.5 percent of 2022 GDP. The tax measures are roughly equally distributed between increases in rates on existing taxes and base broadening measures. We intend to legislate the amendments to the tax code by end-November 2021. We plan to allocate these additional revenues to capital expenditure, and to augment the HUS program allocation when fixed-price gas supply contracts are renegotiated in the spring.

7. To contain fiscal risks, we will scale down the temporary expansion of government guarantees. So far in 2021, we have issued UAH 38.9 billion in government guarantees, and our plans for the remainder of the year, which include the issuance of guarantees for green bonds (see ¶33), are consistent with remaining within the established ceiling. As part of the exit from extraordinary support to the economy, we will no longer suspend, including in the 2022 budget, Article 18.1 of the budget code, which prescribes the ceiling for public guarantees to be set at 3 percent of the planned revenue of the general fund of the state budget. In consultation with the IMF, we will analyze ways to improve the management of guarantees, in line with best practices and with

[3] As defined in ¶13 of the Technical Memorandum of Understanding

the objective of ensuring their consistency with the medium-term fiscal framework and debt sustainability.

8. Fiscal policy in 2022 and beyond will be anchored in our medium-term budget plan, approved by Parliament in June 2021. After allowing the deficit to widen in 2020, we are progressively tightening fiscal policy as the economy recovers and aim to return to primary budget surpluses with a view to (i) reduce gross financing needs and (ii) rebuild fiscal space to allow us to respond to future shocks while keeping debt under 60 percent of GDP. Our policy priorities are outlined in our 2022-24 budget declaration, and include, *inter alia,* the following:

a. **Tax policy will ensure the stability of the tax system, increase its efficiency, and enhance tax administration while minimizing opportunities for abuse**. We have proposed changes to the tax code which—among other things—aim at improving tax administration, limiting scope for abuses (especially for excises, and PIT on sales of real estate), closing some tax loopholes associated with real estate transactions, and improving the valuation of tax base (for corporate income tax and royalties). We have introduced indexation of rates on excises, royalties, and land fees to CPI and PPI, and increased the rates on environmental taxes. To avoid tax evasion in the agricultural sector we have also introduced a minimal tax liability on agricultural land. We will align tax legislation with EU legislation in line with commitments undertaken as part of the Association Agreement between Ukraine and the EU; and have implemented standards to prevent base erosion and profit shifting (BEPS), and the automatic exchange of tax information according to international standards. After a careful technical assessment, we will not move forward with substituting the current Corporate Profit Tax (CPT) for a Distributed Profit Tax (DPT) or an Exit Capital Tax (ECT). We will refrain from widening the eligibility criteria for the simplified tax regime or introducing new groups of taxpayers benefiting from a simplified tax regime and we have started taking steps to prevent tax avoidance and abuse of this regime. We will abstain from introducing new or expanding existing tax preferences, both on a sectoral and regional level, except for potential small scale support mechanisms which will be carefully designed to provide limited and targeted incentives. We will continue to inform the public of the cost of tax exemptions and will broaden the analysis to include the tax expenditure associated with the simplified tax regime.

b. **We will continue to protect the poor and the vulnerable by ensuring that our social programs are appropriately funded.** Although the changes made to the eligibility criteria in 2021 have improved the targeting, the relaxation of the norms during the pandemic and the effects of the lockdown have increased the need for funds. The appropriation in the 2022 budget for the HUS program is sufficient to ensure coverage for the same number of participants as this year if tariffs remain unchanged. However, after the renegotiation of tariffs in the spring, we will ensure that a supplementary budget will identify resources to top up the program in a timely manner and by the required amount.

c. **We will improve our social assistance programs to create a well targeted (means-tested) and affordable social safety net that can effectively support poor and vulnerable households**. With the assistance of the World Bank, we are planning to:

(i) consolidate selected existing assistance programs into our guaranteed minimum income (GMI) scheme, while increasing the size of the program; (ii) combine the GMI program with active labor market policies; and (iii) improve the management information system, including through the digital platform Diya, to enhance the verification of beneficiaries of social programs to improve targeting. We will also take further steps to ensure the sustainability of the social funds, including by streamlining the administration of these funds, and strengthening incentives for recipients of housing and utility subsidies to introduce energy efficient measures.

d. **We will continue implementing the pension reform measures introduced in 2017 aimed at providing better pensions while ensuring the financial stability of the pension system.** The reform was aimed at protecting the elderly against poverty, providing incentives to stay longer in the labor force, applying uniform benefit rules irrespective of professional background, and providing incentives for participation and contribution compliance. We will refrain from: (i) introducing new special pensions or privileges; (ii) providing further discretionary benefit increases; and (iii) adopting changes that would lead to lowering the effective retirement age. We will ensure that any proposed legal amendments, introduced both by laws and by-laws, that will increase pension expenditures are accompanied by a medium-term fiscal impact analysis and a clear identification of the commensurate resources spelled out in the amendments to the PFU budget. We will simplify and streamline the current complex system of old age pension guarantees and we will adopt amendments to the Law on Compulsory Pension Insurance which specify the date of the annual pension indexation. Furthermore, we will continue our collaboration with our development partners to establish well-regulated and fully funded obligatory pension saving schemes when the necessary preconditions are put in place. In addition, will identify appropriate funding resources for the second pillar, and ensure that resources reallocated from the first to the second pillar will be replaced by other revenue sources.

9. We will continue to improve public financial management. We will strengthen our fiscal framework to facilitate sustainable fiscal adjustment and improve the credibility and predictability of fiscal policies. We will enhance our medium-term budget framework (MTBF), embedded into the Budget Code as of 2021, to reinforce fiscal discipline, facilitate informed policymaking, improve monitoring of commitments, and provide predictability in planning and executing budgets. To this end, together with IMF technical assistance, we will: (i) clarify the mechanisms for adjusting expenditure ceilings; (ii) review the arrangements which limit multi-annual commitments; and (iii) improve the methodology to produce forward baseline estimates and fiscal impact assessments especially through capacity building both within the Ministry of Finance (MoF) and in key spending units. We will expand the coverage and strengthen the quantitative analysis of spending reviews based on the pilot projects conducted in 2019-20. In particular, we will conduct a review of the social funds, including the Pension Fund. We will improve the assessment of fiscal risks by developing the necessary tools within the MoF and by expanding our financial model to include major SOEs and will amend Cabinet resolution 7 dd.11.01.2018 on the methodology to assess fiscal risks to improve the submission of information from SOEs necessary to gauge associated fiscal risks. We will operationalize the Debt Management Office with the aim to improve the institutional capacity to manage public debt and to optimize our debt structure and reduce our financing cost. Strategies, operations, and results will be published yearly in the debt management strategy.

10. We are taking decisive steps to improve revenue administration. Specifically:

a. We have established the State Tax Service (STS) and State Customs Service (SCS) as new legal entities, responsible for tax and customs collection. We have developed new organizational structures and frameworks for the delegation of authorities and accountabilities in both organizations as single legal entities. Starting from January 1, 2021, the STS and, from July 1, 2021, the SCS have been operating nationally as two single legal entities both comprising of functionally organized headquarters and field offices and the regional and other legal entities of the STS and SCS, have ceased to exist. While we have not been able to liquidate the State Fiscal Service (SFS) within that same timeframe, and transfer its assets to the STS and SCS, we will complete that process by end-December 2021, when the Ukraine's Bureau for Economic Security (see below) is staffed and fully operational.

b. To improve effectiveness of revenue collection, we will continue building systemic tax compliance risk management process in the STS by developing capacity to detect highest compliance risks and adopt processes that use STS resources with a best possible impact on improving tax compliance. To achieve this, we will: (i) clearly define strategic tax compliance improvement objectives based on analysis of compliance risks and estimation of their potential impact to the tax revenue; and (ii) put in place strong governance arrangements to assure that all functional units of the STS will align their operations to the STS Compliance Strategy. This will be supported by a formal process of adopting annual compliance improvements plans (CIP) with defined and measurable objectives and regular reporting to the STS senior management from functional and structural units of the STS. The CIP for 2022, will be prepared by December 1, 2021. One key objective of the STS Compliance Strategy would be to focus on taxpayer segments that carry highest risks to the tax revenue collections. For this we will continue strengthening the process of managing large taxpayers from large taxpayer offices (LTOs) under the coordination of the head of the STS to achieve consistency in servicing this important taxpayer segment. We will also establish by December 1, 2021 a specialized STS unit to analyze tax behavior of High-Net-Worth Individual taxpayers, to assure that tax compliance risks from this group are minimized.

c. With the goal of consolidating the investigative authority of economic crimes into a single investigative body, the Ukraine's Bureau for Economic Security will become operational by end-December 2021. This authority will take over the responsibility for investigating economic, financial, and tax fraud and crimes that resides with the national police, the state secret service, and the tax police, but with the exception of those instances that fall under the jurisdiction of the National Anti-corruption Bureau of Ukraine (NABU). The law sets out clear rules for management selection, internal decision-making, and oversight to ensure operational independence and proper oversight and accountability.

B. Monetary and Exchange Rate Policies

11. We remain fully committed to an institutionally strong and independent National Bank of Ukraine (NBU), which is crucial for safeguarding macro-economic as well as financial stability. To this end, we [have enacted] amendments to the NBU Law ***(prior action),*** in line with recommendations of the 2019 safeguards assessment, to further strengthen the autonomy and governance of the NBU, including by (i) better describing the role of the NBU Council and its relationship with the Management Board to mitigate interference with the Board's mandate; (ii) reducing the number of NBU Council and audit committee meetings in line with their mandate; (iii) introducing an *ex ante* cooling-off period for Council members to become Management Board members and further clarifying the applicability of existing *ex post* cooling-off period to Council members; (iv) clearly formulating the tenure of NBU deputy governors and improving the appointment and dismissal criteria for the members of Council and Management Board without undermining the status of current members; (v) strengthening conflict of interest rules for NBU officials; and (vi) improving legal protections accorded to these officials, including former NBU officials. We will update our secondary framework (e.g., NBU Council's Rules of Procedure) to align it with the new amendments by end-2021. Furthermore, we will avoid taking any actions that may imply political interference with the NBU's independence (regarding policy decisions, term limits and legal protection of managers and staff, and the NBU's capital and profit distribution rules).

12. Our monetary and exchange rate policies and operations will remain consistent with our commitment to meet the program's international reserve and inflation objectives. We remain committed to steering inflation back to the NBU's target of 5 percent with a tolerance band of ±1 percentage point, letting the exchange rate adjust in line with economic fundamentals and purchasing foreign exchange to meet the program's reserve targets. The NBU stands ready to adjust the policy rate to reach its inflation target over a policy horizon of 9-18 months. Progress in meeting inflation targets will be monitored under the program by consultation bands around the central points of our inflation targets (Table 1). The gradual capital control liberalization envisaged in the February 2019 currency law will be carefully sequenced and conditions-based, without setting specific deadlines for the removal of existing restrictions. As the banking system has weathered the crisis well (see below) and is currently highly liquid with free liquidity at about 30 percent of client liabilities, the NBU has normalized the operational design of its monetary policy by phasing out emergency measures implemented in response to the COVID-19 crisis. As of October 1, 2021, the NBU has discontinued long-term refinancing and interest rate swap operations with banks, reduced the maturity of refinancing loans it offers through weekly tenders from 90 to 30 days and raised the maturity of its certificates of deposits back to the pre-crisis length of 14 days. The NBU will maintain the key policy rate as its core monetary policy instrument and refrain from continuing long-term refinancing operations or conducting any other liquidity providing operations exceeding a maturity of 30 days, unless necessary to safeguard financial stability.

13. The monetary policy consultation clause (MPCC) was triggered by unexpectedly high inflation in March and June 2021. We have attached a separate letter outlining the underlying reasons for the inflation deviation, as well as our policy response (Attachment II). We are confident that the combination of policy interest rate hikes and the unwinding of temporary supply-side factors will bring inflation within the NBU's target range by end-2022.

14. We will take further steps to strengthen the effectiveness of monetary policy and support the development of financial markets. We will strengthen the regulatory framework for financial markets (see below) and continue to work with stakeholders to enhance the efficiency and robustness of money and capital markets, which are important for effective monetary policy transmission.

C. Financial Sector Policies

15. We will pursue policies to ensure financial stability and limit potential fiscal cost of interventions. Our priorities will focus on: (i) further strengthening bank capital requirements; (ii) reducing legacy non-performing loans (NPLs) and recovering assets from resolved banks; (iii) implementing the reform strategy for state-owned banks (SOBs); (iv) improving the Deposit Guarantee Fund's (DGF) financial position and the NBU Emergency Liquidity Assistance (ELA) framework; and (v) developing the regulatory framework for the non-bank financial sector and financial markets.

16. The banking sector has weathered the crisis well. Banks entered the crisis well capitalized and liquid, thanks to our considerable progress in cleaning up the banking system since 2014. Regulatory measures introduced in 2020 to deal with the impact of the COVID-19 pandemic on banks' credit risk were unwound between April and July 2021, with the exception of measures directed at municipalities. Measures to support banks' liquidity (long-term refinancing operations and interest rate swaps) were also suspended in October 2021. Asset quality reviews, conducted by external auditors in all banks, and stress tests conducted in the 30 largest banks (accounting for 93 percent of system assets) showed the banking system as a whole to be profitable and adequately capitalized at end-2020. Based on these diagnostics, the NBU instructed four banks in August 2021 to take measures and/or raise additional capital to cover capital needs found under the baseline scenario by end-December 2021 and instructed these and sixteen additional banks to submit action plans to further improve their capital adequacy by injecting capital and/or reducing risk by end-June 2022, in response to the adverse scenario. We will take supervisory measures against banks that fail to implement their action plans.

17. We have enacted amendments to the Banking Law and DGF Law *(both prior actions)* in line with program commitments, to strengthen the bank supervision framework and the DGF's asset recovery framework:

a. **Through amendments to the Banking Law and other laws we have strengthened the bank supervision framework** by bringing the corporate governance framework in line with the Basel's Guidelines for Corporate Governance for banks (including the collective suitability of supervisory boards), improving shareholder and licensing requirements, improving the capital structure, and granting the NBU legal powers to calibrate bank-specific capital and liquidity requirements. Following a three-year transitional period, the regulatory framework will comply with the Basel II, pillar 2 capital framework and the Basel III capital and liquidity framework. We have adopted a time-bound implementation schedule to ensure that banks will be fully compliant with the new framework by January 2025.

b. **Through amendments to the DGF Law and other laws we have** improved bank liquidation mechanisms and strengthened the DGF's asset recovery powers. Among others, these amendments enhance the DGF's powers to set aside suspicious transactions concluded before the bank's insolvency and facilitates the DGF's ability the claim damages from former bank owners and related parties, including interim measures (asset seizures) against such parties under certain circumstances.

18. We are taking actions to further strengthen the financial safety net and financial stability, also addressing a number of past safeguards assessment recommendations.

a. **We have submitted to Parliament legal amendments that restore the DGF's solvency and make state-owned Oschadbank a member of the DGF.** Based on a plan prepared by the MoF and the DGF and adopted by the Financial Stability Council in August 2020, the law converts into contingent liabilities remaining liabilities related to MoF's back-up funding in 2015-18 to facilitate the DGF's payout of insured deposits in failed banks. The contingent liabilities will be settled with (i) the DGF's recovered claims from failed banks and (ii) with funds that exceed the DGF's target size, as approved by the DGF Administrative Council. The law also gradually raises the insured deposit coverage limit to reach its 2014 value in real terms (from UAH 200,000 to UAH 600,000), establishes a process for determining the DGF's target size, and explicitly requires that any funding from the NBU to the DGF is at NBU's discretion, is short-term, addresses urgent situations, and when systemic stability aspects are at stake (addressing a 2019 safeguards assessment recommendation). We aim to adopt the law by mid-November 2021 and restore DGF's solvency by end-December 2021.

b. **Supported by IMF technical assistance, we are reviewing our operational framework for ELA,** including its governance, the verification of the solvency requirement, appropriate collateralization and risk management conditionality, and monitoring through the implementation of funding plans. To mitigate risk when regular refinancing operations of commercial banks would need to be switched to ELA, we will also strengthen the counterparty eligibility criteria (solvency criteria) in the NBU's monetary policy refinancing operations (a 2019 safeguard assessment recommendation). We will develop changes to the ELA policy and operational framework by end-May 2022. Following bilateral technical assistance from a member of the European System of Central Banks, we will review the operational process for the NBU's emergency liquidity support and assess (with the involvement of the DGF) the legal framework concerning the NBU's secured creditor status in bank resolution and liquidation, and prepare amendments to strengthen this status, as appropriate.

c. **To mitigate and effectively address potential risks posed to financial stability and public finances due to potential adverse rulings** from the constitutional challenges filed against the DGF Law and the Bank Resolution Law (Law No. 590 of 2020), we have prepared a contingency plan for the DGF Law and updated the existing contingency plan prepared at the onset of the Fund-supported program to mitigate and effectively address potential risks posed to financial stability and public finances by adverse court rulings against past resolution decisions. We will ensure that that plans (i) are operationally feasible; (ii) safeguard financial stability; (iii) minimize fiscal costs; and (iv) minimize moral hazard risks. The Financial Stability Council will adopt the plans by end-November 2021 and continue to review the level of preparedness of all stakeholders at its regular meetings and update the plans as needed upon material developments.

19. We have reviewed banks' first recovery plans and we are implementing our time-bound plans to introduce new capital and liquidity requirements. All banks have submitted recovery plans and the NBU has completed its first round of comments. The plans will become part of NBU's annual Supervisory and Review Evaluation Process in 2022. The Net Stable Funding Ratio (NSFR) for banks was implemented in April 2021, originally set at 80 percent to be gradually raised to 100 percent in April 2022. Risk weights for unsecured consumer loans were raised in July 2021, to address rapid growth in this credit segment. In January 2022, capital requirements for operational risk are set to take effect. Also, in 2022, NBU will endorse the requirements to provide the internal capital adequacy assessment process (ICAAP) and the internal liquidity adequacy assessment process (ILAAP). Based on the Banking Law, these requirements will take effect in August 2024. We will introduce a schedule for activating the new capital conservation buffer and the systemic importance buffer by March 2022. Preliminary estimates show that banks are generally prepared for the new capital requirements, and that the additional burden on capital ratios will not be significant.

20. We are fully committed to preserving the strength of supervision and will take resolute measures to support continuity of bank supervision. Earlier this year, we conducted a self-assessment of the NBU's supervisory approach, tools and reporting against the relevant Basel Core Principles. We will prepare and adopt a plan to address the identified regulatory gaps by end- 2021. We are preparing to change the organizational structure for bank supervision, including by establishing a new expert unit than will provide technical support to the more compliance-based supervisors. To increase the likelihood of effective oversight within the new structure and mitigate operational risk stemming from high staff turnover, we will adopt a time-bound action plan, in consultation with IMF staff, to improve professional capacity of bank supervision (a ***structural benchmark*** for end-December 2021). The plan will include the development of professional profiles needed and a multi-year training program for new hires.

21. While considering how best to serve our expanded mandate, we will maintain collegial Board decision-making and our function-based structure. In light of the NBU's recently acquired mandate for non-bank financial institutions (NBFIs) supervision, and amendments to the NBU Law in June 2021 introducing a new (sixth) deputy governor position to the NBU Board, we are developing a plan for regrouping of NBU's organizational units, in addition to the organizational reform of supervision described in ¶20. To ensure efficient information flow and effective decision making, we will continue to pursue collegial decision-making by the Board and its committees, and the function-based, lean organization model that we have implemented over the past years with IMF support. To this end, at the governance level, the NBU will identify upfront an effective and balanced division of responsibilities among the Board members, taking into account the collegial model of decision-making, while avoiding potential conflicts between executive responsibilities. At the organizational level, the NBU will also identify activities that can be conducted cross-sectorally and examine the merit of grouping these together. Additional organizational safeguards will be considered, such as establishing new senior staff committees (advisory or for information-sharing) across departments, as needed. Critically, we will ensure that any organizational reforms will enhance internal information-sharing and decision-making, retain key staff, ensure business continuity is not hampered, and are easy to explain internally and externally, thereby minimizing reputational risk.

22. We are taking steps to advance the corporate governance reforms for banks under state-control, including by upgrading accountability mechanisms. We have operationalized the oversight unit in the MoF in charge of shareholding management in line with IMF technical assistance recommendations and are committed to filling currently vacant staff position quickly with high-caliber professionals. Each SOB has adopted a Code of Ethics that establishes a balanced disciplinary process to handle misconducts, complaints, and conflicts within the banks, including involving supervisory board members. A new Memorandum of Understanding (MoU) between the MoF and the majority-independent supervisory boards of each of the SOB will be signed by end-October 2021, providing a balanced relationship framework to ensure commercial independence of state-owned banks and accountability to the State as a shareholder In consultation with International Financial Institutions (IFIs), we have developed a methodology for assessment of the supervisory board's performance conducted by an internationally reputable advisor (to strengthen accountability), which considers obstacles that are outside the supervisory board's control and may reduce their effectiveness and tasks the advisor to propose measures to improve corporate governance and supervisory board efficiency. The first performance assessment will be conducted for each of the banks in 2022 (based on the 2021 performance) and will inform the Cabinet's performance assessment in line with Article 7 of the Banking Law. In June 2022, the MOF will publish the assessment's key findings, together with Cabinet's actions to address the findings.

23. To build on that momentum, we are committed to promptly addressing recent risks to the oversight of banks under state control. Changes to the recently approved Banking Law relaxed the eligibility criteria for state representatives in SOBs' supervisory boards, creating risk of weakened oversight. To mitigate this risk, we will, by end-November, enact legal amendments, prepared jointly by the Ministry of Finance and the NBU, that reverse this relaxation (end-November 2021 ***structural benchmark).*** The term of Ukrgasbank's supervisory board members expires in April 2022, and we are committed to select new members through a competitive and transparent process. In the remaining three SOBs, the three-year term of the majority-independent supervisory board members expires in June 2022, and we will, by end-February 2022, initiate the selection process for new supervisory board members in line with Article 7 of the Banking Law. In light of that, by endNovember, we will, in consultation with IFIs, adopt a time-bound succession plan for the supervisory boards of each of the SOBs that support the implementation of the approved 2021-2024 strategies for each of the banks ***(structural benchmark,*** end-November 2021). The succession plan will lead to the revision of relevant resolutions and procedures (including, but not limited to Cabinet Resolution No. 159 and 267 of 2019), in consultation with IFIs, with the objective to (i) strengthen the qualification criteria for international recruitment firms, including by ensuring rotation and effective leadership and endorsement by a reputable foreign partner; (ii) ensure that the recruitment firm's procedure for shortlisting candidates is consistent with banks' approved strategies and with the objective of collective suitability of each of the new boards reflects the respective bank's approved strategy; (iii) elaborate the process for the Nomination Committee's selection from the already shortlisted candidates (including verification, evaluation and voting); and (iv) provide for a transparent process for reappointing a person to the position of an independent member of a supervisory board. We will offer market-based remuneration to attract and motivate highly qualified Ukrainian and international professionals.

24. Consistent with the Principles of State Banking Sector Strategic Reforms, we will advance preparations to reduce state ownership in the banking sector. The updated Strategy, approved by the Cabinet in August 2020, envisions a reduction in state ownership from the current 50.4 percent in net assets (total assets net of loan loss provisions) to below 25 percent by 2025. An important first step was taken in 2020, when the International Finance Corporation (IFC) of the World Bank Group granted a loan to UkrGasBank, that is convertible into equity. We are fully committed to facilitate the process of privatization of UkrGasBank, as laid out in its approved strategy. To support a potential pre-privatization engagement, which would be based on a convertible debt instrument that would already augment Oschadbank's regulatory capital (tier 2), the European Bank for Reconstruction and Development (EBRD) conducted due diligence of Oschadbank in June 2021. Cabinet has approved Oschadbank's strategy for 2021-24 and the MoF and Oschadbank will enter formal negotiations with EBRD about the terms and conditions of cooperation in line with the approved strategy. To further advance the state's divestment, we will ensure that Privatbank and Oschadbank will, by end-year 2021, develop and adopt, in cooperation with the MoF, a road map that (i) outlines the steps required to take each of these banks to the market for partial or full privatization and advance our objective to attract reputable international investors; (ii) identifies legal amendments that might be required to execute the divestment option(s) presented. These road maps will be endorsed by the Cabinet by end-January 2022 ***(structural benchmark).*** To strengthen the oversight of SOBs and prepare for divestment, we will enhance the professional capacity of the shareholder management unit within the MoF's Department for Financial Policy. Furthermore, we will ensure that the banks under state control remain adequately capitalized and meet capital requirements. Any additional decisions that may affect state ownership in the banking sector (including, but not limited to the acquisition of corporate right by government bodies and state-owned enterprises (e.g., UkrPoshta)) would be undertaken only if consistent with the government's overall strategy to reduce state ownership and control in the banking sector, ringfencing the banking services in a separate legal entity, which will be subject to international best practices including stringent licensing safeguards (such as prudential vetting of shareholders).

25. We have made progress in reducing legacy NPLs in SOBs. All SOBs have prepared time bound and credible NPL reduction plans, which were endorsed by the Financial Stability Council in June 2020. Applying the comprehensive legal and regulatory framework for managing problem assets, adopted in 2018-2020, all the banks are on track with the implementation of their plans, resulting in their combined NPL ratio falling from 65 percent at end-December 2019 to 52 percent at end-August 2021, on the back of write-offs of fully provisioned NPLs. Implementation of these plans will continue to be subject to quarterly monitoring by the FSC and the NBU and annual evaluation under the NBU's Supervisory Review and evaluation Process (SREP) and be part of the banks' annual Key Performance Indicators. While balance sheet repair will help revive lending, we have identified a set of key obstacles to bank lending. To this end, the NBU and respective ministries will, together with the banking community, review recommendations submitted by the working group set up to identify obstacles in bank lending, with the aim to prepare an actionable plan, by end-January 2022.

26. We are stepping up our efforts to boost asset recovery from the former owners and related parties of failed banks to reduce the cost of bank failures to Ukrainian taxpayers and hold such persons accountable for wrongdoings. The recently adopted legal amendments strengthen the DGF's framework for asset recovery framework (i.e., the recovery of claims against former bank owners and related parties, including damages inflicted by them) (MEFP ¶[18a]). Another amendment is in Parliament to strengthen the DGF's ability to seek damages in criminal proceedings. In addition, the DGF will pursue legal actions abroad to recover losses and engage with reputable legal and forensic experts to that end. These efforts will be supported by effective coordination with law enforcement agencies and by ensuring DGF's solvency, which will create more financial space and incentives for the DGF to commit the required resources to take these steps. However, we recognize the need to take a more comprehensive approach to pursue all commercial and legal avenues available to recover assets from failed banks and hold former owners and former managers of failed banks accountable for losses. This comprehensive approach would demonstrate a strong political commitment and provide a consolidated view on Ukraine's asset recovery strategy, on policy measures that will fix institutional, legal and coordination gaps forestalling recoveries, with due attention paid to the fact that, while relevant agencies are trying to recover assets, the state continues to do business with the former owners of failed banks as usual, via public procurement and privatization. We are thus fully committed to the following actions:

a. **Develop an asset recovery strategy and action plan**. We have launched a high-level working group chaired by the Prime Minister, with the NBU Governor as Deputy Chair, and convening all relevant ministries, as well as the Prosecutor General's Office (PGO) and NABU upon their consent, to prepare a comprehensive asset recovery strategy paper and action plan, to be adopted and published by the Cabinet of Ministers ***(structural benchmark*** for end-February 2022). Given the relevance of their work, we will extend the membership of this high-level working group to other law enforcement agencies. The strategy would set asset recovery as a policy goal, take stock of the status of asset recovery efforts, identify impediments to asset recovery, define our strategy, and propose credible and time-bound concrete policy actions to strengthen legal framework, increase the institutional and operational capacity of relevant agencies, and establish effective and structured coordination mechanisms among relevant agencies to that end. We will ensure that the proposed actions will not give rise to any moral hazard risk and that there will be no interference with the operational autonomy of respective agencies and PrivatBank's asset recovery efforts. Inter alia, we will specifically enumerate measures that can be taken to end the state's business-as-usual with former owners of failed banks until the latter have taken actions to satisfy their debts to the DGF, for example, by prohibiting former bank owners of resolved banks, their related parties, and entities controlled by them, with legally ascertained debts to the DGF, from participating in public procurement and privatization processes.

b. **Ensure continuous cooperation.** While the above strategy paper is being developed, the NBU and the DGF will continue to coordinate their efforts with the PGO and NABU, including by way of exchange of information and documentation (e.g., forensic audit reports), as permitted by law and without prejudice to the prosecutorial and investigative autonomy of PGO and NABU respectively.

c. **Agencies involved in asset recovery will continue to adequately inform the public on progress made.** To that end, the CMU publishes semi-annual reports summarizing progress in asset recovery and litigation efforts related to the SOBs. The DGF will continue such reporting in relation to liquidated banks, including by publishing on its website the list of all borrowers, managers, and former bank shareholders of resolved banks that are yet to honor their debts, including credit debts, to the failed institutions as ruled by court decisions. The DGF will also disclose semi-annually the amount of damage it claims from former owners and related parties in each failed bank. The DGF will increase the accessibility of its reports with easily understandable and comparable information. In addition, for enhanced transparency around outcomes, the Prosecutor General's Office will publish a semi-annual report on the outcomes of criminal proceedings against former bank owners, managers, and other related parties in each resolved bank since the beginning of 2014, with aggregate data on the number of persons investigated, tried, and convicted as well as the amount of fines and damage recovered ***(structural benchmark*** for end-December 2021).

27. We will strengthen the legal, regulatory, and supervisory framework for NBFIs and financial markets. The NBU has adopted new rules on shareholder transparency, which requires all NBFIs (apart from credit unions) to disclose their owners and those with non-transparent ownership structures to change their ownership structure by October 17, 2021. We will take supervisory actions against those NBFIs that do not meet this requirement. To strengthen NBFI supervision, we have, with support from IFIs, prepared new legislation on Financial Services and Financial Companies (#5065), on Insurance (#5315) and on Credit Unions (#5125). Another draft law amends the Law on the National Securities and Stock Market Commission (NSSMC), enhancing NSSMC's independence and institutional capacity, its cross-border and domestic cooperation mandate, and its enforcement powers. We will ensure that this law meets the objectives outlined in ¶22 of the September 1, 2016 MEFP and allows Ukraine to become a signatory of IOSCO's multilateral MoU. We will closely coordinate with the staff of the relevant IFIs to ensure that these four draft laws are aligned with international best practices and aim for these laws to be enacted by Parliament by end-December 2021. We will expand the coverage of the centralized credit registry to the non-bank credit institutions and lower the threshold for submitting information both for banks and non-banks.

D. Structural Policies

Anticorruption and rule of law

28. We remain committed to good governance and rooting out high-level corruption. Building on the successful establishment of Ukraine's anti-corruption institutions—the National Anticorruption Bureau of Ukraine (NABU), the Specialized Anticorruption Prosecutor's Office (SAPO), the High Anti-Corruption Court (HACC), and the National Agency for Corruption Prevention (NACP)—we will continue to uphold their independence, enhance their effectiveness, and secure the adequacy of their resources. Robust implementation of the asset declaration and AML/CFT frameworks is intended to advance efforts to hold corrupt public official accountable. We will avoid any backtracking from the progress made to our anti-corruption efforts.

a. **NABU Operations.** We will continue to safeguard the institutional and operational independence of the NABU and ensure its effectiveness in investigating corruption. The powers of the President over the NABU (including the authority to appoint its head) were declared unconstitutional by the September 2020 decision of the Constitutional Court. To address this legal gap, we [have amended] the NABU law ***(prior action)*** to: (i) protect NABU's independence as a central executive authority with special status under the Cabinet of Ministers (including resolving conflicts of laws in favor of NABU's independence and enhancing the existing external audit model to be conducted by independent experts with international experience); (ii) enhance the selection process for the new NABU head by giving a decisive role to independent experts with international experience with at least two votes of independent experts in the six-member Selection Commission required for majority and split decisions; and (iii) confirm the current NABU head's status in order to prevent legal challenges to NABU's ongoing work and provide a smooth transition of credibly selected NABU leadership until a new NABU head is selected. We will also maintain NABU's exclusive authority to investigate acts of corruption involving significant amounts or committed by high-level officials and empower its effective use of a wide range of investigative techniques in line with international AML/CFT standards without having to rely on other agencies' infrastructure. Thus, to implement the law allowing the NABU to intercept communications, we will provide adequate resources, equipment, and technological solutions to enable the NABU to independently intercept communications of landlines and mobile devices by end-December 2021. In addition, we will continue to maintain adequate financial and human resources for NABU and ensure that staff remuneration remains competitive. By end-March 2022, further amendments to the legal framework will be undertaken to allow the NABU access to competent, independent, and speedy forensic examinations by experts, in criminal proceedings in relation to corruption cases under the NABU's jurisdiction. We will ensure that the NABU will have primary jurisdiction over criminal cases of corruption within its investigative jurisdiction over other law enforcement agencies, including the new State Bureau of Economic Security. To monitor its activities, NABU and SAPO will publish in their respective websites quarterly statistics on corruption cases being investigated and prosecuted as well as pending cases before the HACC (in line with the template detailed in the TMU).

b. **False Asset Declaration.** We restored criminal liability against public officials with respect to their obligations to file asset declarations ***(prior action).*** In an October 2020 decision, the Constitutional Court invalidated the previous law on the grounds of lack of proportionality of sanctions against public officials who intentionally fail to submit or make false entries in their asset declarations. Consistent with the December 2020 Opinion of the European Commission for Democracy through Law (Venice Commission), a new law was enacted in June 2021 that created three separate corruption offenses of (i) non-submission of asset declaration; (ii) ordinary false declaration (involving assets below the threshold amount of US$170,000); and (iii) aggravated false declaration (involving assets valued above the threshold amount). The serious offense of aggravated false declaration will be punishable by imprisonment for up to two years. Together with the revised offense of illicit enrichment, the new offenses on asset declaration should help contribute to an effective and dissuasive asset declaration system.

c. **SAPO.** We will ensure the autonomy of SAPO. We will complete the selection process and appoint a new SAPO head by end-November 2021. Based on the lessons learned from the ongoing selection process of the new SAPO head, we will amend the SAPO law (end-March 2022 ***structural benchmark):*** (i) to improve the procedures for selection of SAPO officials with the crucial role and decisive vote of independent experts with international experience; (ii) strengthen its capacity to regulate its organizational activities including rationalizing the powers of the SAPO head and its deputies; and (iii) establish mechanisms for accountability of SAPO leadership based on the findings and recommendations of the external audit to be conducted by independent experts with international experience in anti-corruption law enforcement, in conjunction with the NABU audit.

d. **Anticorruption court.** We fully support the independence of the HACC and will aim to ensure that it is adequately provisioned to perform its mandate. Since its successful establishment, the HACC is demonstrating its capacity to hold corrupt public officials accountable. In the past two years, more than 80 percent of the HACC's decisions have led to convictions for corruption against judges, prosecutors, former members of parliament, heads of state-owned enterprises (SOEs) and local officials. We will continue to ensure the full operationalization of the HACC by providing adequate financial resources for its activities (including staffing, security and IT requirements and maintaining competitive staff remuneration) and ensuring a permanent, dedicated, and adequate suitable facility for the HACC. By end-December 2021, the HACC will be provided title to use and manage permanent offices that are appropriate for its needs. The HACC will publish reports on its performance with respect to the number and types of corruption cases, decisions on convictions or acquittals, and penalties imposed (in line with the template detailed in the TMU).

e. **E-declaration.** To mitigate illicit enrichment and laundering of proceeds of corruption, we will continue to ensure that politically exposed persons (PEPs) are subject to comprehensive and published asset declaration requirements. In the same October 2020 decision on false asset declaration, the Constitutional Court abolished the powers of the (NACP) on the grounds that the power to verify asset declarations were contrary to the principle of judicial independence. To address these concerns, and in response to the recommendations of the Venice Commission (December 2020 Opinion), we enacted in December 2020 amendments to the NAPC law restoring their powers with respect to verification of asset declaration but carved out a separate regime for asset declarations for the judiciary. In this regard, we continue to work with the judicial branch to finalize procedures for verification of asset declarations of members of the judiciary. We continue to ensure and facilitate NABU's automatic and unrestricted electronic access to the NAPC database of asset declarations. We remain focused on efforts to prioritize the verification of asset declarations of PEPs based on risk.

f. **AML implementation.** We are mobilizing the AML/CFT framework to support efforts to tackle high-level corruption. To implement the December 2019 amendments to the AML/CFT framework, we issued guidance to banks on the new definition of PEPs. In undertaking supervisory and enforcement actions, we are aiming to utilize the proportionate and dissuasive sanctions provided under the new AML/CFT framework in cases of breaches of obligations. By end-March 2022, we will improve the beneficial ownership information contained in the Unified State Register of Legal Entities, Entrepreneurs and Public Associations with mechanisms to sanction legal entities for non-compliance, ensure open and public access to its information, and require that financial institutions report any discrepancies. To monitor its contribution to anti-corruption efforts, the State Financial Monitoring Service of Ukraine (the country's financial intelligence unit) will continue publishing quarterly statistics on the information it disseminates to NABU (in line with the template detailed in ¶100 of the TMU). With respect to the voluntary tax declaration, we will ensure that this program fully complies with AML and anti-corruption legislation and the risks of abuse and money laundering are sufficiently mitigated. In this regard, the NBU will publish after the voluntary tax declaration program a thematic inspection report of AML/CFT compliance by banks that facilitated tax declarations through special accounts (including random sampling of beneficiaries). The NBU will continue to conduct at least four quarterly inspections of banks at higher risk of laundering of the proceeds of corruption, focused on regulatory requirements related to customer due diligence and PEPs, including with regard to requirements to identify PEPs, to verify their source of wealth and beneficial ownership information.

29. We will strengthen the rule of law by ensuring the independence, integrity, and accountability of the judiciary. We will ensure that the judicial selection processes and disciplinary mechanisms are managed and implemented by persons with high competence, trustworthiness, and integrity consistent with European judicial standards and Venice Commission opinions. We will strengthen the administrative procedures to give sufficiently superior level of judicial consideration to cases challenging the decisions of national state agencies and provide proper safeguards against undue influence on decision-making.

a. **High Council of Justice (HCJ)**. We amended the HCJ Law to enhance the selection process ensuring that its members have impeccable reputation and integrity ***(prior action).*** As one of the judicial self-governance bodies, the HCJ is a constitutionally created body that has appointment and disciplinary functions over judges in general. In July 2021, we amended the law governing its selection process to create an Ethics Council to pre-screen potential candidates to the HCJ and assess their integrity as well as perform a one-off integrity check of existing HCJ members. Consistent with the recommendations in the May 2021 opinion of the Venice Commission, the first composition of the six-member Ethics Council will have three independent experts with international judicial experience and will be given a decisive vote (at least two of these three independent experts would be required in majority decisions and split votes). The procedures and criteria for the pre-selection process for the HCJ candidates, including a call by the commission for applications, has been outlined. The Ethics Council will forward those candidates that have passed the pre-screening to the respective appointing authorities as designated by the Constitution for final selection and approval. In case of negative assessment by the commission of an existing HCJ member, the Ethics Council will send and publish a recommendation for dismissal to the relevant appointing authority. The HCJ member subject of the negative assessment will be temporarily suspended from office until such time as the relevant appointing authority decides on the dismissal. We will undertake all necessary actions to establish the Ethics Council by end-October 2021. In addition, the one-off integrity check of existing HCJ members would be completed within the six-month period from the establishment of the Ethics Council as provided under the law (end-April 2022 ***structural benchmark).***

b. **HCJ Disciplinary Inspectorate Service**. We have also created a permanent inspectorate unit in the HCJ to support the conduct of judicial disciplinary investigations. Under the same July 2021 amendments to the HCJ law, this new standalone unit in the HCJ will be responsible for investigating disciplinary cases against judges and submitting recommendations to the HCJ for disciplinary actions and sanctions. The unit will be composed of permanent staff, who will be subject to competitive selection, in order to ensure consistency in investigative practice and continuity and evenhandedness in the treatment of judicial disciplinary cases.

c. **Review of Exemplary Administrative Cases**. We will amend the procedural codes to transfer the judicial review of exemplary administrative cases against national state agencies to the Supreme Court, as a court of first instance, and to the Grand Chamber of the Supreme Court, as an appellate court. In further consultation with stakeholders and agreement with IMF staff, the criteria for determining exemplary administrative cases to be transferred to the Supreme Court will be finalized by end-December 2021. The criteria will include such factors as cases of national importance, cases above a pre-determined threshold amount, or having significant impact or damage to the country, and will cover the decisions, acts, or omissions of specific national state agencies (such as Cabinet of Ministers, Ministries, National Bank of Ukraine, Anti-Monopoly Committee, HCJ, NABU, NACP, HACC).

Energy Sector Reforms

30. We will continue our efforts to avoid the re-emergence of quasi-fiscal deficits in the gas sector by setting tariffs above cost recovery while protecting vulnerable households. Specifically:

a. **Protecting vulnerable households.** We will continue providing utility subsidies to help defray the impact of gas and heating tariffs on low-income and vulnerable households. To this end, as described in ¶4a and ¶8b, we will ensure adequate budget allocation for the HUS in accordance with gas price forecasts and strive to ensure coverage of all qualifying households prior to the heating season, including by better informing the public and eliminating rigidities in registration.

b. **Preventing quasi-fiscal deficits**

- We are committed not to reintroduce any price cap on gas supplied to households, and to ensure that wholesale prices are determined on a transparent and efficient market. We will also ensure that all heating tariffs under the jurisdiction of local authorities are reviewed and officially enacted to fully reflect gas and non-gas costs (including capex) by end-October 2021. Any deviation from the cost recovery level caused by the surge in gas prices will be covered by an explicit and transparent subsidy from either the state or respective local budget.

- To support such efforts, we will (i) make fully operational the supervisory board of Naftogaz by the end of January 2022, and (ii) ensure that an independent audit is conducted by an internationally reputable firm by April 2022, focusing on measuring the extent to which Naftogaz activities and fixed price contracts represent a subsidization of gas prices for households and DHCs.

- Before restructuring the debt of DHCs and Distribution System Operators (DSOs), we will implement and assess the results of measures which aim to address the underlying causes of debt accumulation. Such measures would include ensuring cost reflective heating tariffs and sufficient working capital in DHCs, as well as measures improving payment discipline (see ¶30c below).

c. **Enforcing payment discipline.** We will address the issue of payment discipline of households, district heating companies and distributors to secure the continuity of gas nominations and to help the development of a competitive market. We will develop adequate instruments for district heating companies to enforce collection of payments from households (including via higher fines and simplified legal enforcement). We will refrain from any measures which may undermine payment discipline.

31. We are committed to protecting the financial strength of MGU/GTSO and their ability to invest without delay in critical gas transport infrastructure in response to structural challenges in this sector. We will soon make fully operational the supervisory board of MGU, including by ensuring all appointed members have been provided contractual agreements. As the supervisory board was not appointed when the recent agreement replacing the original SPA was renegotiated, we are committed to providing all necessary information to the supervisory board, to allow it to assess whether the implications of this agreement are in the company's best interests, does not jeopardize its short-term liquidity position and medium-term viability, and fosters its capacity to invest, including its capacity to invest in response to structural shifts in the transportation network. Based on the findings of that thorough assessment, we are committed to amending the relevant CMU resolution governing payment terms.

32. We will take further steps to support the development of energy markets by implementing measures to enhance competition and consumer choice. Our measures will include:

a. **Enhancing competition in the retail market**

- We will further simplify the procedure for supplier switching for household consumers, including by ensuring it cannot be hampered by the existence of a disagreement between the household consumer and the previous supplier or by any claims of payments outstanding. In addition, we will ensure household consumers have the right to authorize sharing their historic consumption data, and DSOs will be required to provide access to their historic consumption data to any supplier of the household consumer's choosing. Such provision of data must be done free of charge. To facilitate this, we will ensure that all the by-laws required for finalizing the launch a joint data hub for household consumers will be approved by December 2021. The data hub will then be made accessible to all market participants by end-March 2022 (**a structural benchmark**).
- We will create a working group with key stakeholders including NEURC, the Ministry of Energy and the Anti-Monopoly Committee of Ukraine (AMCU) whose task will be to develop and promulgate by end-March 2022 a joint workable action plan to ensure development and enforcement of market and anti-monopoly regulations, including effective unbundling of DSOs and suppliers in all regions so that they cannot have the same beneficial owner. The regulator will be responsible for verifying the effectiveness of the unbundling. We will also adopt legislation to ensure (i) AMCU's financial and operational independence; (ii) that the appointment of its Chairman and commissioners is transparent, competitive and insulated from political interference and a clear exhaustive list of reasons for their dismissal is provided; (iii) that its powers are strengthened to conduct physical searches, confiscate documents and to obtain information from, and share information with law enforcement agencies and other government bodies; and (iv) that its decisions will gain the status of enforcement documents, so that there is no need for a court process to enforce decisions. Finally, AMCU will publish information on the initiation and results of its investigations.

b. **Enhancing competition in the wholesale market.** We will ensure that wholesale prices are determined on a transparent and efficient market. Against this objective, we will implement a domestic gas release program under which, starting in May 2022, UGV will sell every year at least 40-50 percent of its production on a transparent and competitive basis on local exchanges with equal access for all market participants. This share is expected to increase toward 100 percent by 2024 as fixed price contracts currently tying up production expire. In parallel, we will also develop a workable action plan to improve financial stability and institutional capacity of the demand side (including DHCs) to make sure they are capable of sourcing gas through an exchange. We will speed up our progress towards full implementation of the EU Regulation on wholesale Energy Market Integrity and Transparency (REMIT) as envisaged under the Association Agreement between Ukraine and the EU. We will develop an action plan to improve transparency and ensure commercial attractiveness of exchange gas trading in Ukraine.

33. We are committed to addressing the large imbalances in the electricity sector. In order to eliminate quasi-fiscal deficits in the electricity sector, we will ensure that:

a. The state-owned Guaranteed Buyer will no longer accumulate arrears to renewable energy producers from 2022 onwards (a new **quantitative performance criterion** - see TMU). To that end, we will ensure that the regulator (NEURC) sets the Transmission System Operator (TSO) transmission tariff at a level sufficient to cover—in addition to material and labor expenses, capital expenditures, dividend payments, and profit tax—all obligations to renewable producers (including 100 percent of the value of estimated output of electricity volume produced for the relevant year) as well as financial expenses in relation to debt service and principal payment of existing and planned borrowing. This borrowing would include financing in form of loans or issuance of bonds until December 31, 2021 to repay all arrears accumulated in 2020 and 2021 in the limits permitted by the ceiling on issuance of publicly guaranteed debt.

b. Energoatom will maintain revenues that can at least cover power generation costs and basic investment needs after paying the compensation described in the CMU resolution #859 on Public Service Obligations (PSO) for households, including by rescinding resolutions that allowed Energoatom and other producers to sell large volumes of electricity significantly below market prices to other entities. We will closely monitor payment discipline between the Universal Service Providers, oblenergos, the Guaranteed Buyer, and Energoatom and Ukrhydroenergo. Furthermore, we will introduce measures to strengthen the governance of Energoatom. Specifically, we will ensure that the Law on corporatization of Energoatom is enacted by end-December 2021, including a requirement to produce financial accounts according to international standards. We will ensure that a supervisory board with a majority of independent members selected through a transparent and robust procedure is established by end-May 2022 (a **structural benchmark**).

SOE reform - Corporate Governance and Privatization

34. We reiterate our strong belief in the importance of sound corporate governance in SOEs. We will ensure that SOEs will operate at arm's length of the government, by safeguarding progress made in strengthening corporate governance, including by maintaining majority-independent supervisory boards. In particular, as discussed in ¶30b and ¶33b, we will make fully operational the supervisory board of Ukrenergo by end-December 2021, Naftogaz by the end of January 2022, and Energoatom by end-May 2022, based on transparent and competitive selection procedures. Furthermore, we will adopt an SOE corporate governance law to further strengthen the SOE corporate governance framework by bringing it in line with OECD Guidelines on Corporate Governance of SOEs, including by strengthening the accountability and broadening the powers of supervisory boards so they have the ultimate authority to appoint and dismiss CEOs. We have adopted an overarching accounting policy in line with IFRS to be implemented by SOEs and we will adopt an overarching state ownership policy.

35. We remain committed to significantly downsizing the SOE sector. We will enact legislation simplifying the transfer of assets to the State Property Fund (SPF), streamlining the privatization process, and extending the period during which companies can be sold under UK Law by at least three years. In parallel, we will continue our efforts to strengthen the institutional capacity of the SPF. The SPF will aim to launch tenders for the sale of at least 3 large SOEs by end-December 2021, including United Mining and Chemical Company, First Kyiv Machine-Building Plant, and the President Hotel. We will continue with the sale of small companies and assets and leasing of state property through open, competitive, and transparent two-tier electronic auctions (ProZorro.Sale).

Table 1. Ukraine: Quantitative Criteria and Indicative Targets 1/

(End of period; millions of Ukrainian hryvnias, unless otherwise indicated)

	2020									2021							2022
	June			September			December			March			June			December	March
	PC	Adj. PC	Act.	PC	Adj. PC	Act.	PC	Adj. PC	Act.	IT	Adj. IT	Act.	IT	Adj. IT	Act.	PC	PC
I. Quantitative performance criteria																	
Ceiling on the cash deficit of the general government (- implies a surplus) 2/	180,000	170,636	19,412	217,000	216,043	83,245	302,150	301,936	249,819	45,000	39,022	17,231	90,000	82,149	42,094	237,000	47,000
Ceiling on the cash deficit of the general government and Naftogaz (- implies a surplus) 2/	180,000	170,636	52,112	217,000	216,043	121,645	302,150	301,936	287,719	45,000	39,022	2,331	90,000	82,149	33,294	237,000	47,000
Floor on net international reserves (in millions of U.S. dollars) 3/	12,268	11,864	17,229	9,137	9,954	15,546	7,567	10,141	17,878	9,618	10,310	16,799	10,296	11,720	17,978	19,264	20,521
Ceiling on publicly guaranteed debt 2/	40,000	44,877	27,121	40,000	44,877	27,121	40,000	44,877	48,531	20,000	29,845	9,845	20,000	29,845	38,936	70,000	35,000
Ceiling on stock of arrears of the Guaranteed Buyer to RES 1/	-	-	-	-	-	-	-	-	25,618		-	-			16,300	0	0
II. Continuous performance criterion																	
Ceiling on accumulation of new external debt payments arrears by the general government 3/	0	0	0	0	0	0	0	-	0	0	-	0	0	-	0	0	0
III. Monetary Policy Consultation Clause (MPCC)																	
Inflation target 4/	5.0	-	2.4	5.0	-	2.3	5.0	-	5.0	5.0	-	8.5	5.0	-	9.5	5.0	5.0
IV. Indicative Targets																	
Ceiling on net domestic assets of the NBU 3/	225,670	235,240	124,559	287,818	268,462	199,655	319,300	258,335	172,525	278,166	261,780	210,759	269,552	235,819	219,188	232,856	178,465
Ceiling on stock of CIT prepayment arrears 6/	0	-	-1,572	0	-	-4,080	0	-	4,894	0	-	3,666	0	-	6,018	0	0
Ceiling on stock of VAT refund arrears	0	-	551	0	-	531	0	-	519	0	-	282	0	-	164	0	0
Ceiling on primary expenditure of the state budget and social funds 2/ 7/	n.a.	-	n.a.	n.a.	-	n.a.	1,437,000	-	1,491,660	n.a.	-	n.a.	n.a.	-	n.a.	1,594,790	n.a.
V. Memorandum Items																	
Naftogaz deficit (- implies a surplus) 2/	0	-	32,700	0	-	38,400	0	-	37,900	0	-	-14,900	0	-	-8,800		
External project financing 2/	14,300	-	6,298	18,900	-	12,419	22,700	-	18,075	6,000	-	1,145	12,000	-	5,170	17,000	6,400
NBU Profit transfers to the government 2/	n.a.	-	n.a.	n.a.	-	n.a.	42,720	-	42,720	33,000	-	0	33,000	-	24,434	24,434	13,600
Budget support grants 2/	812.0	-	0	1135.0	-	350.7	2,217	-	361.4	804.0	-	0	804.0	-	0	1,254	402
Government bonds issued for banks recapitalization and DGF financing 2/	20,000	-	0	20,000	-	6,840	20,000	-	6,840	17,000	-	0	17,000	-	0	8,500	17,000
Operations Involving GDP Warrants								-			-			-			
Arrears on social payments							0	-	54	0	-	37	0	-	53	0	0
Programmed market issuance, placements and disbursements of international assistance except IMF (millions of U.S. dollars) 3/ 5/	2,952	-	1,998	3,510	-	3,455	4,510	-	5,372	6,010	-	5,372	6,568	-	7,054	8,647	9,647
Use of swaps with other central banks (millions of U.S. dollars) 3/ 5/	0	-	0	0	-	0	0	-	0	0	-	0	0	-	0	0	0
Debt service on eurobonds or placements (millions of U.S. dollars) 3/ 5/	1,737	-	1,741	3,676	-	3,991	3,758	-	4,077	4,343	-	5,105	4,502	-	5,267	7,960	8,506
Net issuance of central government domestic FX debt (millions of U.S. dollars) 3/ 5/	-385	-	-250	-994	-	-543	-1,180	-	115	-1,280	-	76	-1,449	-	-482	-961	-940
Use of confiscated assets for FX payments or transfer to NBU gross international reserves (millions of US. Dollars) 3/ 5/	0	-	419	0	-	736	0	-	736	0	-	736	0	-	736	736	736
Program accounting exchange rate, hryvnia per U.S. dollar	23.6862	23.6862	23.6862	23.6862	23.6862	23.6862	23.6862	23.6862	23.6862	23.6862	23.6862	23.6862	23.6862	23.6862	23.6862	23.6862	23.6862

Sources: Ukrainian authorities; and IMF staff estimates and projections.

1/ Definitions and adjustors are specified in the November 2021 Technical Memorandum of Understanding (TMU).

2/ Targets and projections for 2020 are cumulative flows from January 1, 2020. Targets and projections for 2021 and 2022 are cumulative flows from January 1, 2021 and January 1, 2022 respectively.

3/ Calculated using program accounting exchange rates of 12/28/2019, specified in TMU of 2020 SBA.

4/ End of period, year-on-year headline inflation.

Outer consultation bands, triggering consultation with the Board, will be +/- 3pp for 2020, 2021 and 2022.

Inner consultation bands, triggering consultation with staff, will be +/- 1pp.

5/ Projections are cumulative from January 1, 2020.

6/ CIT prepayment arrears are measured as cumulative changes from January 1, 2020.

7/ Primary spending of the State budget plus the consolidated spending of pension and social funds.

Table 2. Ukraine: Prior Actions and Structural Benchmarks	
Prior Actions	**Status**
Enact amendments to the NBU Law that strengthen autonomy and governance of the NBU (¶11)	Met
Enact amendments to the Banking Law to improve banks' corporate governance framework, capital structure, and shareholder and licensing requirements, and grant the NBU legal powers to calibrate capital and liquidity requirements (¶17.a)	Met
Enact amendments to the DGF Law to improve bank liquidation mechanisms and strengthened the DGF's asset recovery powers (¶17.b)	Met
Enact amendments to the NABU law to provide legal certainty on its continued effective and independent operation and on the status of its head (¶28.a)	Met
Enact Law to reimpose criminal liability for false asset declarations, consistent with constitutional requirements (¶28.b)	Met
Enact amendments to the High Council of Justice (HCJ) Law to enhance the selection process ensuring that its members have impeccable reputation and integrity (¶29.a)	Met
Structural Benchmarks	**Completion Date**
Approve a 2022 budget targeting a general government deficit of 3.5 percent of GDP	End-November 2021
Enact legal amendments to reverse the relaxation of eligibility criteria for state representatives to supervisory boards of state-owned banks (¶23)	End-November 2021
Adopt time-bound succession plans for the supervisory boards of each of the SOBs, consistent with the approved 2021-2024 strategies for each of the banks (¶23)	End-November 2021
Complete and publish the audit of the of the remaining portion of the funds spent out of the Covid-related spending program (¶2)	End-December 2021
NBU will adopt a time-bound action plan, in consultation with IMF staff, to improve professional capacity of bank supervision (¶20)	End-December 2021

Table 2. Ukraine: Prior Actions and Structural Benchmarks (concluded)	
The Prosecutor General's Office to publish a semi-annual report on the outcomes of criminal proceedings against former bank owners, managers, and other related parties in each resolved bank since the beginning of 2014, with aggregate data on the number of persons investigated, tried, and convicted as well as the amount of fines and damage recovered (¶26c)	End-December 2021
Cabinet will endorse a roadmap that outlines the steps required to take PrivatBank and Oschadbank to the market for partial or full privatization and advance the objective of attracting reputable international investors (¶24)	End-January 2022
Adopt and publish a comprehensive asset recovery strategy paper and action plan (¶26a)	End-February 2022
Enact amendments to the SAPO law to improve the selection procedures of SAPO officials, strengthen its capacity to regulate its organizational activities, and establish mechanisms for accountability of SAPO leadership (¶28c)	End-March 2022
Develop and make available to all gas suppliers a consumer database with all the information necessary for a new supplier to bill households (¶32a)	End-March 2022
Complete the one-off integrity check of existing HCJ members by the Ethics Council in line with provisions in the new HCJ law (¶29a)	End-April 2022
Appoint a supervisory Board in Energoatom with a majority of independent members selected through a transparent and robust procedure (¶33b)	End-May 2022

Table 3. Ukraine: Proposed Revised Schedule of Reviews and Available Purchases

Availability Date	Millions of SDR	Percent of Quota	Conditions
June 9, 2020	1,500	74.6	Board approval of the Stand-by arrangement
September 1, 2020	500	24.9	First review and continuous and end-December 2020 performance criteria
March 4, 2022	500	24.9	Second review and continuous and end-December 2021 performance criteria
June 3, 2022	1,100	54.7	Third review and continuous and end-March 2022 performance criteria
Total	3,600	178.9	
Memorandum item:			
Quota	2,011.8		

Source: IMF staff calculations.